



Regular Meeting

Item Number 7 – Open Session

Subject: Review of CalSTRS Funding Levels and Risks Report

Presenter(s): David Lamoureux and Rick Reed

Item Type: Information

Date & Time: November 2, 2022 – 30 minutes

Attachment(s): Attachment 1 – 2022 Review of Funding Levels and Risks Report

PowerPoint(s): Summary of Review of Funding Levels and Risks Report

Item Purpose

The purpose of this item is to present the 2022 Review of Funding Levels and Risks report. This report is intended to assist the board and CalSTRS stakeholders in assessing the soundness and sustainability of the system and to better understand how the CalSTRS Funding Plan is expected to accomplish its goal of achieving full funding by 2046.

Recommendation

This is an information item only.

Executive Summary

The Review of Funding Levels and Risks report provides the board and stakeholders the opportunity to take an in depth look at the CalSTRS Funding Plan and discusses a variety of risks associated with the funding of the Defined Benefit Program.

The attached report includes four main sections which focus on the following:

Path to full funding: Section detailing the significant changes in the past year and their impact on long-term funding levels and contribution rates under the current actuarial assumptions. **Key findings:** Despite the investment loss experienced by CalSTRS in 2021–22, CalSTRS remains ahead of schedule in its goal to reach full funding. Neither the state nor the employer contribution rates will need to be increased in fiscal year 2023–24 to eliminate their respective shares of the unfunded actuarial obligation by 2046.

The risk environment: Section exploring the risks that could prevent the Defined Benefit Program from reaching full funding by 2046, focusing specifically on the risk related to longevity, membership and payroll decline, and future investment returns. **Key findings:** Although continued decreases in enrollment in K-12 public schools could put pressure on CalSTRS' ability to reach full funding long term if it results in decreases in the number of teachers, investment risk continues to be the most significant risk facing the CalSTRS Funding Plan. Because it has a funding plan in place, CalSTRS remains in a favorable position to withstand a future recession and keep the funding plan on track.

Measures of plan maturity and volatility: Section detailing the continuing trend of maturation of the Defined Benefit Program and its impact on contribution rate volatility. **Key findings:** The maturing of the Defined Benefit Program combined with the 2046 end date of the funding plan will make it harder for CalSTRS to react to an investment loss in the future.

Ability to reach full funding under different actuarial assumptions: Section investigating the ability of the funding plan to reach full funding by 2046 under more conservative economic actuarial assumptions. **Key findings:** CalSTRS would still be expected to reach full funding should the board elect to adopt more conservative actuarial assumptions in the funding of the system. However, contributions would have to increase for the state, for the employers and possibly for CalSTRS 2% at 62 members.

Background

CalSTRS continually monitors the funding plan and the financial health of the fund. Formal assessments of funding levels and risks are provided to the board twice a year. These formal assessments are presented in the spring through the annual actuarial valuation report and in the fall through the Review of Funding Levels and Risks report. In addition to these two formal reports, CalSTRS provides updates to the board on the status of various funding-related risks as part of the semi-annual enterprise risk management report. These semi-annual reports are generally presented in March and September of each year.

This year's Review of Funding Levels and Risks report is based on the results of the June 30, 2021, actuarial valuation that was presented to the board in May 2022 and reflects the events that have taken place over the last fiscal year. Specifically, the report reflects the negative investment return earned by CalSTRS in fiscal year 2021–22 and reflects the significant increase of about 20,000 in the number of active teachers experienced over the last fiscal year. The increase in the number of teachers resulted in an increase of 6% in the payroll, exceeding the assumed 3.5% annual growth.

CalSTRS is also required by statute to provide a progress report on the funding plan to the Legislature every five years. The first report was provided in June 2019. The next report is due in June 2024. This report provides CalSTRS an opportunity to educate the Legislature about the funding plan, the health of the fund and the risks encountered in funding the Defined Benefit Program.

For the next progress report to the Legislature, the board will have the opportunity to discuss and consider whether improvements should be recommended to the Legislature to further strengthen the funding plan and CalSTRS' ability to reach full funding. Making minor modifications to the funding plan, by addressing certain features, would help mitigate the impact of some of the risks identified in this report. These features include the end date of 2046, the inability to address the unallocated share of the unfunded actuarial obligation, the 0.5% limit on increases to the state contribution rate, and the requirement that the state contribution rate immediately drops to 2.017% of payroll once the state has eliminated its share of the unfunded actuarial obligation. Note that in March 2021, the California Legislative Analyst's Office published a report recommending that minor modifications be made to strengthen the funding plan to address some of these features.

Finally, in fiscal year 2022–23, CalSTRS will perform the asset liability management study that occurs every four years. This process is critical to the long-term sustainability of CalSTRS. It is used to assist the board in making the very important decision of how to invest the CalSTRS portfolio. At the same time, CalSTRS will perform its formal review of the actuarial assumptions. This also is an important step in the continued monitoring of the funding plan. It helps ensure the actuarial assumptions used to assess funding levels are consistent with long-term expectations. CalSTRS will perform the review of actuarial assumptions in 2023 and present the findings and recommendations to the board for adoption in early 2024.

Strategic Plan Linkage: Goal 1: Ensure a well-governed, financially sound trust fund.

Optional Reference Material:

[June 2019 Report to Legislature on the Progress of the CalSTRS Funding Plan](#)

[Legislative Analyst's Office - Strengthening the CalSTRS Funding Plan](#)